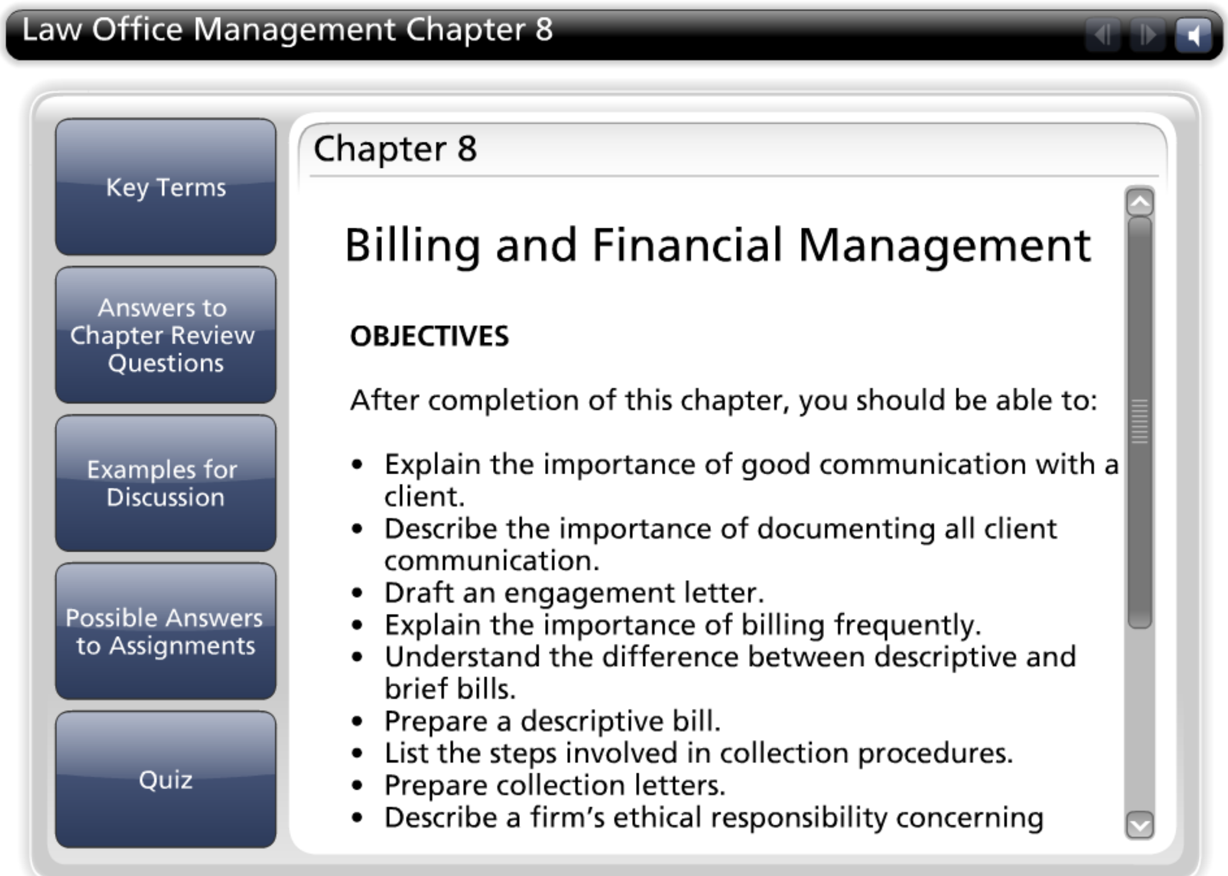
Law Office Management Chapter 8

Chapter 8



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Billing and Financial Management

OBJECTIVES

After completion of this chapter, you should be able to:

• Explain the importance of good communication with a client.
• Describe the importance of documenting all client communication.
• Draft an engagement letter.
• Explain the importance of billing frequently.
• Understand the difference between descriptive and brief bills.
• Prepare a descriptive bill.

• List the steps involved in collection procedures.
• Prepare collection letters.
• Describe a firm’s ethical responsibility concerning billing.
• Discuss some problems of the billing process.
• Describe the factors that affect a firm’s profitability.
• Calculate an employee’s realization rate.
• Identify the types of income and expenses in a law firm.
• Estimate projected law firm income and expenses.
• Calculate a firm’s expense percentage and discuss the various ways it is used.

Key Terms

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1. **Arbitration**: The resolution of a dispute without court involvement.

2. **Block billing**: Charging a client for services rendered in one large block of time rather than itemizing the tasks performed in that period of time.

3. **Compensation expenses**: Employee expenses, including wages and benefits.

4. **Cost recovery system**: A utility program that allows data to be transferred to a billing program by copier or telephone systems.

5. **Direct profitability factors**: Factors that affect a firm's profitability in a short period of time, usually one year.

6. **Discovery**: The acquisition of notice or knowledge of given acts or facts; that which was previously unknown.

7. **Downsize**: To reduce staff and expenses because of reduced income.

8. **Engagement letter**: A letter summarizing the scope of representation and the fee agreement between a lawyer and a client.

9. **Fee adjustment memorandum**: A form used by an attorney to increase or decrease a client's bill as appropriate.

10. **Fee allocation**: When a percentage of the bill is given to the originating or supervising attorney as compensation.

11. **Fiduciary**: Of, relating to, or involving great confidence and trust; a person who transacts business for another person, necessitating great confidence and trust by the second party and a high degree of good faith by the first.

12. **Gross income**: Income received before payment of expenses.

13. **Indirect profitability factors**: Factors that indirectly affect a firm's profitability over a longer period, more than one year.

14. **Operating expense**: Expenses other than compensation expenses that include occupancy costs, office operating costs, costs of professional activities, and general business expenses.

15. **Per unit cost**: The amount of money it costs to produce a product or provide a service.

16. **Preliminary bill**: A bill prepared for an attorney's review and consideration for adjustment.

17. **Realization**: The process of turning time into cash.

18. **Realization rate**: The hourly rate of a timekeeper that the firm actually realizes when all accounts have been collected compared to the total amount billed.

19. **Team churning**: Making frequent changes in the legal team.

20. **Write-down**: A decrease in the amount owed because of a discount.

21. **Write-off**: A credit for the total amount owed.

22. **Write-up**: An increase in the amount owed because of a premium.

Answers to Chapter Review Questions

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Following are answers to the Chapter Review Questions found in the text.

1. The main goal of a firm's billing policy is to get bills paid promptly (p. 269).

2. The five steps of the realization process are getting the work, doing the work, recording the work, billing the work, and collecting the bills (p. 292).

3. Communication is the most important aspect of the billing process (p. 269).

4. An engagement letter is a letter sent to a client that summarizes the terms of the client's retention of the firm (p. 271).

5. When communicating with clients, a non-lawyer should not:

   A. Discuss the duration of the matter;
   B. Estimate the cost of the matter; or
   C. Give an opinion as to the possible outcome of a matter (pp. 270-271).

6. Regular and frequent billing is important because clients prefer to receive smaller monthly bills rather than larger infrequent bills. Further, a client's perception of the value of the service diminishes over time (p. 271).

7. A preliminary bill is a bill that is prepared for the attorney's review. The attorney may add or subtract charges to the bill (p. 274)

8. The two methods lawyers use to extend credit to their clients are loans and credit cards (p. 275).

9. The elements contained in a descriptive hourly bill that are not contained in a brief hourly bill are:

   A. Date of service;
   B. Initials of timekeeper;

C. Description of service;
D. Time increment;
E. Individual cost of services;
F. Itemization of costs; and
G. Billing code (pp. 277-278).

10. The difference between an hourly bill and a flat fee bill is that the detail of services performed is unnecessary and a breakdown of services by timekeeper is unnecessary with a flat fee bill (p. 276).

11. The four most common unethical billing practices are:

A. Applying a client's funds to a disputed fee;
B. Charging more than a client agreed to pay;
C. Charging for services not rendered to a client;
D. Increasing a flat fee (p. 284).

12. A legal auditor is one who audits bills for law firms to discover errors or ensure compliance with client-directed billing policies (p. 285)

13. Direct profitability factors are factors that affect a law firm's profitability in a short period of time-less than one year (p. 289).

14. Indirect profitability factors are factors that affect a law firm's profitability in a long period of time-more than one year (p. 290).

15. A realization rate is the amount of money a firm actually receives from the work of a timekeeper It is calculated by subtracting the percentage of uncollectible income attributable to a timekeeper from 100 percent (p. 291).

16. The three projections of a law firm budget are income, personnel costs, and operating expenses (pp. 293-294).

17. The four types of operating expenses in a law firm are:

A. Occupancy costs;
B. Office operating costs;
C. Costs of professional activities; and
D. General business expenses (p. 294).

18. An expense percentage is the percentage of

expenses to law firm income. It is calculated by dividing expenses by income (p. 294).

Examples for Discussion

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1. *United States v. DeLorean*
Mr. Wietzman has violated all of the aspects of effective billing techniques: communication, understanding, regular and frequent bills, and descriptive bills. Since he kept no time sheets that described his efforts, it would be difficult for a judge to determine if his fee was reasonable.

This case also illustrates how a client's perception of the services rendered decreases over time. At the time of his acquittal, DeLorean would probably have paid Wietzman the additional fees. However, as time passes, the value of the service decreases, and a dispute develops.

If Wietzman's fee is directly related to the amount of time and effort involved in the case, then his actions are ethical. However, if he increased his fee, or charged DeLorean for services not rendered, his actions are unethical. We can assume from his comment that his fee was based on factors other than time and effort. If so, Wietzman's actions would be unethical.

The factors of TOCATPET involved are: time and labor required, other employment opportunities, and experience, reputation, and ability of the lawyer. Since Wietzman is a prominent attorney, his fee should be more than that of a less prominent attorney.

2. The Sixfold Bill
This scenario is an example of value billing. Since the six answers had the same value, they should cost the client the same. However, in this instance, Robert told Geraldo that he would charge him by the hour, not by the project. Thus, his bill to Geraldo is inappropriate.

3. The Modified Agreement
The engagement letter on page 272 does not indicate that an increased hourly rate would be charged if the issues are complex, so we can

assume that Emily never mentioned the possibility of a fee increase in her discussions with Pete. Therefore, the fee increase would be denied unless it could be proven that Emily discussed a possible fee increase with Pete at the beginning of the representation. To eliminate the possibility of this problem happening again, a clause should be inserted in the fee agreement and engagement letter that an hourly rate may be increased if the issues are complex.

4. Hourly or Flat Fee?

1. The information comes from the times of the timekeepers in the Domestic Relations Department.

2. Flat fees are established applying the timekeeper's hourly rate to the average time it tales to complete the work.

3. Individual response.

Possible Answers to Assignments

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Following are possible answers to Assignments provided in the text. The responses below are a guide to what an instructor would look for within the student's response. Some assignments are based solely on individual experience and/or opinion, and a general response for such questions is not provided.

1. Individual student response.

2. Individual student response.

3. Individual student response.

4. Individual student response.

5. Click on the diagram to see the projected gross income.

6. The firm’s projected net income for the year is as follows:

$2,155,350 × 62% (expense percentage) = $1,336,317
$2,155,350 - $1,336,317 = $819,033

7. Each partner’s projected income for the year is as follows:

$819,033 ÷ 2 = $409,516.50

However, a firm never disburses all its net income to the owners. Money is left in the firm’s operating account to meet payroll and expenses. Each firm decides on the percentage of net income to be disbursed to the owners. This figure represents net income for the firm that is available to the owners if they withdraw 100 percent of the money.

Quiz

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Click here to take the Chapter Quiz.